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AUDITOR-GENERAL
SOUTH AFRICA

REPORT OF THE AUDITOR-GENERAL TO THE LIMPOPO PROVINCIAL LEGISLATURE AND THE COUNCIL ON THE MODIMOLLE LOCAL MUNICIPALITY

REPORT ON THE FINANCIAL STATEMENTS

Introduction

1. I have audited the financial statements of the Modimolle Local Municipality, as set out on pages xx to xx, which comprise the statement of financial position as at 30 June 2013, the statements of financial performance, changes in net assets and cash flows for the year then ended, and the notes, comprising a summary of significant accounting policies and other explanatory information.

Accounting officer's responsibility for the financial statements

2. The accounting officer is responsible for the preparation and fair presentation of these financial statements in accordance with the South African Standards of Generally Recognised Accounting Practice (SA Standards of GRAP) and the requirements of the Municipal Finance Management Act of South Africa, 2003 (Act No. 56 of 2003) (MFMA),and the Division of Revenue Act, 2012 (Act No. 5 of 2012) (DoRA) and for such internal control as the accounting officer determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor-General's responsibility

3. My responsibility is to express an opinion on these financial statements based on my audit. I conducted my audit in accordance with the Public Audit Act of South Africa, 2004 (Act No. 25 of 2004) (PAA), the *General Notice* issued in terms thereof and International Standards on Auditing. Those standards require that I comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

4. An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgement, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

5. I believe that the audit evidence I have obtained is sufficient and appropriate to provide a basis for my adverse audit opinion.

Basis for adverse opinion

Prior period errors

6. SA Standards of GRAP 3, *Accounting policies, change in accounting estimates and errors* requires material prior period errors to be corrected retrospectively by restating the comparative amounts for the prior periods in which the error occurred. The municipality has not corrected all its prior period errors for the periods in which the errors occurred, as the impact of the errors on the 2012 opening accumulated surplus have not been disclosed. Furthermore, I was unable to verify prior period corrections

amounting to R19 596 798 as disclosed in note 35 to the financial statements. Consequently, I was unable to determine whether any adjustment relating to the prior period corrections were necessary.

7. SA Standards of GRAP 3, *Accounting policies, change in accounting estimates and errors* requires material prior period errors to be corrected retrospectively by restating the comparative amounts for the prior periods in which the error occurred. I have noted that the statement of financial position, the statement of financial performance, the statement of change in net assets and the cash flow statement were not adjusted with all the prior period errors as disclosed in note 35 to the financial statements. Furthermore I was unable to ascertain the effect of the adjustments to the affected account balances. As a result, the municipality has not complied with GRAP 3.

Inventory

8. During 2012 I was unable to obtain sufficient appropriate audit evidence regarding inventory. I was unable to confirm the inventory by alternative means. Consequently, I was unable to determine whether any adjustments to inventory stated at R6 512 166 was necessary. My audit opinion on the financial statements for the period ended 30 June 2012 was modified accordingly. My opinion on the current period's financial statements is also modified because of the possible effect of this matter on the comparability of the current period's figures as disclosed in note 9 to the financial statements amounting to R6 097 986 (2012: R6 512 166).

Cash and cash equivalents

9. During 2012 I was unable to obtain sufficient appropriate audit evidence regarding cash and cash equivalents. I was unable to confirm the cash and cash equivalents by alternative means. Consequently, I was unable to determine whether any adjustments to cash and cash equivalents stated at R55 498 861 were necessary. My audit opinion on the financial statements for the period ended 30 June 2012 was modified accordingly. My opinion on the current period's financial statements is also modified because of the possible effect of this matter on the comparability of the current period's figures as disclosed in note 12 to the financial statements amounting to R56 119 794 (2012: R55 498 861).

10. I have identified unreconciled items to the amount of R4 210 438 which were included in the year-end bank reconciliation. I was unable to confirm the reconciling items by alternative means. Consequently, I was unable to determine whether any adjustments relating to cash and cash equivalents as disclosed in note 12 to the financial statements amounting to R56 119 794 were necessary.

11. Included in cash and cash equivalents is a bank account amounting to R4 142 073 for which no sufficient appropriate audit evidence could be provided. I was unable to confirm the amount by alternative means. Consequently, I was unable to determine whether any adjustments to the cash and cash equivalents as disclosed in note 12 to the financial statements amounting to R56 119 794 were necessary.

Property, plant and equipment

12. During 2012 I was unable to obtain sufficient appropriate audit evidence regarding property, plant and equipment. I was unable to confirm the property, plant and equipment by alternative means. Consequently I was unable to determine whether any adjustments to property, plant and equipment stated at R818 700 339 was necessary. My audit opinion on the financial statements for the period ended 30 June 2012 was modified accordingly. Although certain changes were made, my opinion on the current period's financial statements is also modified because of the possible effect of this matter on the comparability of the current period's figures as disclosed in note 4 to the

financial statements amounting to R829 114 122 (2012: R818 700 339), due to the unresolved scope limitations identified during the previous financial period.

Payables from exchange transactions

13. Included in payables from exchange transactions are trade payables, other creditors and retentions amounting to R18 757 806 for which no sufficient appropriate audit evidence could be provided. I was unable to confirm these payables from exchange transactions by alternative means. Consequently I was unable to determine whether any adjustments to the accounts payables as disclosed in note 17 to the financial statements amounting to R31 246 400 were necessary.

14. Included in payables from exchange transactions are journal entries amounting to R18 763 016 (2012: R5 009 243) for which no sufficient, appropriate audit evidence could be provided. I was unable to confirm these journal entries by alternative means. Consequently, I was unable to determine whether any adjustments to the accounts payable figure as disclosed in note 17 to the financial statements amounting to R31 346 400 were necessary.

Receivables from exchange and non-exchange transactions

15. During 2012 I was unable to obtain sufficient appropriate audit evidence regarding receivables from exchange and non-exchange transactions. I was unable to confirm the receivables from exchange and non-exchange transactions by alternative means. Consequently, I was unable to determine whether any adjustments to receivables from exchange and non-exchange transactions stated at R51 158 273 was necessary. My audit opinion on the financial statements for the period ended 30 June 2012 was modified accordingly. My opinion on the current period's financial statements is also modified because of the possible effect of this matter on the comparability of the current period's figures.

16. The SA Standards of GRAP 104, *Financial Instruments*, requires the municipality to develop an accounting policy which highlights the methods and assumptions used to determine the fair value of each class of financial assets or financial liabilities. The municipality has developed and disclosed its assumptions for the calculation of its impairment provision for receivables from exchange and non-exchange transactionsin note 1.1. to the financial statements, but has not applied the assumptions disclosed. The municipality's records did not permit the application of alternative procedures regarding this amount. Consequently, I was unable to determine whether any adjustment relating to the impairment provision for receivables from exchange and non-exchange transactions as disclosed in note 10 of the financial statements amounting to R24 401 712 (2012: R23 229 062) was necessary.

17. The SA Standards of GRAP 9, *Revenue from exchange transactions*, requires the municipality to disclose an analysis of the age of the financial assets per customer type. The disclosures in the financial statements of receivables from exchange and non-exchange transactions per notes 10 and 11 were not made in accordance with the requirements of GRAP 9.

Value Added Tax (VAT)

18. Included in the VAT payable balance at year-end are VAT journal entries amounting to R929 331 (2012: R5 278 632) for which no sufficient, appropriate audit evidence could be provided. I was unable to confirm these journal entries by alternative means. Consequently, I was unable to determine whether any adjustments to the VAT payable amount as disclosed in note 18 amounting to R21 136 174 (2012: R15 633 778) were necessary.

19. I have identified VAT amounting to R1 016 124 which were claimed without the municipality having a valid tax invoice. As a result, operating expenditure is overstated and VAT payable understated by R1 016 124.

20. The municipality could not provide me with supporting documentation for a difference identified between the general ledger and the VAT 201 returns amounting to R5 178 502 (2012: R18 933 123). The municipality's records did not permit the application of alternative procedures regarding this amount. Consequently, I was unable to determine whether any adjustments to the VAT payable amount as disclosed in note 18 amounting to R21 136 174 (2012: R15 633 778) were necessary.

Irregular expenditure

21. During 2012 I was unable to obtain sufficient appropriate audit evidence regarding irregular expenditure. I was unable to confirm the irregular expenditure by alternative means. Consequently, I was unable to determine whether any adjustments to irregular expenditure stated at R5 551 832 was necessary. My audit opinion on the financial statements for the period ended 30 June 2012 was modified accordingly. My opinion on the current period's financial statements is also modified because of the possible effect of this matter on the comparability of the current period's figures.

Revenue

22. During 2012 I was unable to obtain sufficient appropriate audit evidence regarding revenue. I was unable to confirm the revenue by alternative means. Consequently, I was unable to determine whether any adjustments to revenue stated at R217 303 126 was necessary. My audit opinion on the financial statements for the period ended 30 June 2012 was modified accordingly. My opinion on the current period's financial statements is also modified because of the possible effect of this matter on the comparability of the current period's figures.

Expenditure

23. During 2012 I was unable to obtain sufficient appropriate audit evidence regarding expenditure. I was unable to confirm the expenditure by alternative means. Consequently, I was unable to determine whether any adjustments to bulk purchases stated at R65 946 770 was necessary. My audit opinion on the financial statements for the period ended 30 June 2012 was modified accordingly. My opinion on the current period's financial statements is also modified because of the possible effect of this matter on the comparability of the current period's figures.

24. I was unable to obtain sufficient appropriate audit evidence for expenditure to the amount of R15 951 321 (2012: R 2 195 188). The municipality's records did not permit the application of alternative procedures regarding this amount. Consequently, I was unable to determine whether any adjustments to the bulk purchases, contracted services and general expenses as disclosed in notes 32, 31 and 24 to the financial statements amounting to R111 721 184 were necessary.

Employee expenditure

25. During 2012 I was unable to obtain sufficient appropriate audit evidence regarding employee expenditure. I was unable to confirm the employee expenditure by alternative means. Consequently, I was unable to determine whether any adjustments to employee expenditure stated at R63 055 485 was necessary. My audit opinion on the financial statements for the period ended 30 June 2012 was modified accordingly. My opinion on the current period's financial statements is also modified because of the possible effect of this matter on the comparability of the current period's figures.

Contingent liabilities

26. The municipality has not disclosed a contingent liability in respect of the uncertainties arising from the dispute declared by the unions and the pending litigation regarding the wage curve agreement. I was unable to confirm the contingent liabilities by alternative means. Consequently, I am unable to determine whether any adjustments to the contingent liability disclosed as R1 543 803 (2012: R734 000) in note 34 to the financial statements was necessary.

Financial instruments

27. SA Standards of GRAP 104, *Financial instruments,* requires an entity to disclose information that enable users of its financial statements to evaluate the nature and extent of risks arising from financial instruments to which the entity is exposed at the end of its reporting period. In contravention to GRAP 104, the municipality has not disclosed the nature and extent of risks arising from financial instruments to which the municipality is exposed at the end of its reporting period.

Budget information

28. SA Standards of GRAP 24, *Presentation of budget information in the financial statements,* requires entities to disclose, by way of a disclosure note, an explanation of material differences between the budget, for which the municipality is held publicly accountable and the actual amounts. In contravention with GRAP 24, the municipality has not disclosed any explanations for material differences between the budget and the actual amounts.

Adverse opinion

29. In my opinion, because of the significance of the matters described in the Basis for adverse opinion paragraphs, these financial statements do not present fairly the financial position of the Modimolle Local Municipality as at 30 June 2013 and its financial performance and cash flows for the year then ended, in accordance with SA Standards of GRAP and the requirements of the MFMA.

Emphasis of matters

30. I draw attention to the matters below. My opinion is not modified in respect of these matters.

Restatement of corresponding figures

31. As disclosed in notes 35 and 36 to the financial statements, the corresponding figures for 30 June 2012 have been restated as a result of errors discovered during 2013 in the financial statements of the municipality at, and for the year ended, 30 June 2012.

Material underspending of the budget and conditional grants

32. As disclosed in the statement of comparison of budget and actual amounts, the municipality has materially underspent on its budget to the amount of R20 996 862. As a consequence, the municipality has not achieved all of its objectives in the planning and development department.

33. With reference to note 15 to the financial statements, the municipality materially underspent on its conditional grants for the year under review by R23 875 993. This was mainly due to the late appointment of contractors.

Unauthorised expenditure

34. As disclosed in note 39 to the financial statements, the municipality incurred unauthorised expenditure of R516 678 (2012: R16 369 651) as a result of the overspending of the total amount appropriated in the municipality's approved budget.

Irregular expenditure

35. As disclosed in note 41 to the financial statements, the municipality incurred irregular expenditure amounting to R506 397 (2012: R5 551 832) due to contraventions of the supply chain management regulations.

Fruitless and wasteful expenditure

36. As disclosed in note 40 to the financial statements, the municipality incurred fruitless and wasteful expenditure of R162 963 (2012: R557 325) as a result of interest and penalties paid due to late payments made to suppliers.

Additional matters

37. I draw attention to the matters below. My opinion is not modified in respect of these matters.

Unaudited supplementary schedules

38. The supplementary information set out on pages XX to XX does not form part of the financial statements and is presented as additional information. I have not audited these schedules and, accordingly, I do not express an opinion thereon.

REPORT ON OTHER LEGAL AND REGULATORY REQUIREMENTS

39. In accordance with the PAA and the *General Notice* issued in terms thereof, I report the following findings relevant to performance against predetermined objectives, compliance with laws and regulations and internal control, but not for the purpose of expressing an opinion.

Predetermined objectives

40. I performed procedures to obtain evidence about the usefulness and reliability of the information in the annual performance report as set out on pages XX to XX of the annual report.

41. The reported performance against predetermined objectives was evaluated against the overall criteria of usefulness and reliability. The usefulness of information in the annual performance report relates to whether it is presented in accordance with the National Treasury's annual reporting principles and whether the reported performance is consistent with the planned development objectives. The usefulness of information further relates to whether indicators and targets are measurable (i.e. well defined, verifiable, specific, measurable and time bound) and relevantas required by the *National TreasuryFramework for managing programme performance information (FMPPI).*

    The reliability of the information in respect of the selected development objectivesis assessed to determine whether it adequately reflects the facts (i.e. whether it is valid, accurate and complete).

    The material findings are as follows:

Usefulness of information

Presentation

Measures taken to improve performance not disclosed

42. Section 46 of the Municipal Systems Act 2000. (Act No. 32 of 2000) (MSA) requires disclosure jn the annual performance report of measures taken to improve performance where planned targets were not achieved. Measures to improve performance for all of the planned targets not achieved, were not reflected in the annual performance report.

This was due to an inadequate review of the presentation of the annual performance report by management, including the accounting officer.

Consistency

Reported objectives not consistent with the planned objectives

43. The MSA, section 41(c) requires that the integrated development plan should form the basis for the annual report, therefore requiring the consistency of objectives, indicators and targets between planning and reporting documents. A total of 57% of the reported indicators and targets are not consistent with the indicators and targets as per the approved integrated development plan. This is due to the lack of review of the reported performance information by management, including the accounting officer.

Reliability of information

44. The National Treasury *FMPPI* requires that institutions should have appropriate systems to collect, collate, verify and store performance information to ensure valid, accurate and complete reporting of actual achievements against planned objectives, indicators and targets.

    I was unable to obtain the information and explanations I considered necessary to satisfy myself as to the reliability of information presented with respect to the basic service delivery objective.

    This was due to the fact that the municipality could not provide sufficient appropriate evidence in support of the information presented with respect to the basic service delivery objective.

Compliance with laws and regulations

45. I performed procedures to obtain evidence that the entity has complied with applicable laws and regulations regarding financial matters, financial management and other related matters. My findings on material non-compliance with specific matters in key applicable laws and regulations as set out in the *General Notice* issued in terms of the PAA are as follows:

Strategic planning and performance management

46. The annual performance report for the year under review does not include measures taken to improve performance, as required by section 46 (1)(c) of the MSA.

47. The internal audit unit did not audit the performance measurements on a continuous basis, as required by Municipal planning and performance management regulation 14(1)(c).

48. The municipality did not have and maintain effective, efficient and transparent systems of financial and risk management and internal controls as required by section 62(1)(c)(i) of the MFMA.

Budgets

49. Expenditure was incurred in excess of the limits of the amounts provided for in the votes of the approved budget, in contravention of section 15 of the MFMA.

Annual financial statements, performance and annual report

50. The financial statements submitted for auditing were not prepared in all material respects in accordance with the requirements of section 122 of the MFMA. Material misstatements identified by the auditors in the submitted financial statements were not adequately corrected, which resulted in the financial statements receiving a adverse audit opinion.

51. The municipality did not conduct its affairs in a manner which was consistent with its integrated development plan, as required by section 36 of the MSA, section 21(2)(a) of the MFMA and Municipal planning and performance management regulation 6.

Audit committees

52. The audit committee did not submit, at least twice during the financial year, an audit report on the review of the performance management system to the council, as required by Municipal planning and performance management regulation 14(4)(a)(iii).

Liability management

53. An adequate management, accounting and information system which accounts for liabilities was not in place, as required by section 63(2)(a) of the MFMA.

54. An effective system of internal control for liabilities (including a liability register) was not in place, as required by section 63(2)(c) of the MFMA.

Procurement and contract management

55. Sufficient appropriate audit evidence could not be obtained that goods and services with a transaction value of below R200 000 were procured by means of obtaining the required price quotations, as required by SCM regulation 17(a) and (c).

56. Sufficient appropriate audit evidence could not be obtained that quotations were accepted from prospective providers who are not registered on the list of accredited prospective providers and do not meet the listing requirements prescribed by the SCM policy in contravention of SCM regulation 16(b) and 17(b).

57. Sufficient appropriate audit evidence could not be obtained that bid specifications for procurement of goods and services through competitive bids were drafted in an unbiased manner that allowed all potential suppliers to offer their goods or services, as per required by SCM regulation 27(2)(a).

58. Sufficient appropriate audit evidence could not be obtained that bid specifications were drafted by bid specification committees which were composed of one or more officials of the municipality as required by SCM regulation 27(3).

59. Invitations for competitive bidding were not always advertised for a required minimum period of days, as required by SCM regulation 22(1) and 22(2)

60. Sufficient appropriate audit evidence could not be obtained that bids were evaluated by bid evaluation committees which were composed of officials from the departments requiring the goods or services and at least one SCM practitioner of the municipality as required by SCM regulation 28(2).

61. Sufficient appropriate audit evidence could not be obtained that contracts and quotations were awarded to bidders based on points given for criteria that were stipulated in the original invitation for bidding and quotations, as required by SCM regulations 21(b) and 28(1)(a) and Preferential Procurement Regulations.

62. Sufficient appropriate audit evidence could not be obtained that bid adjudication was always done by committees which were composed in accordance with SCM regulation 29(2).

63. Sufficient appropriate audit evidence could not be obtained that awards were made to bidders other than those recommended by the bid evaluation committee without ratification by the accounting officer, as required by SCM regulation 29(5)(b).

64. Sufficient appropriate audit evidence could not be obtained that the preference point system was applied in all procurement of goods and services above R30 000 as required by section 2(a) of the Preferential Procurement Policy Framework Act, 2000 (Act No. 5 of 2000) (PPPFA) and SCM regulation 28(1)(a).

65. Sufficient appropriate audit evidence could not be obtained that contracts and quotations were awarded to suppliers based on preference points that were allocated and calculated in accordance with the requirements of the PPPFA and its regulations.

66. Sufficient appropriate audit evidence could not be obtained that contracts and quotations were awarded to bidders that scored the highest points in the evaluation process, as required by section 2(1)(f) of PPPFA. Contracts and quotations were awarded to providers whose tax matters had not been declared by the South African Revenue Service to be in order, as required by SCM regulation 43.

67. Contracts were extended or modified without tabling the reasons for the proposed amendment in the council of the municipality, as required by section 116(3) of the MFMA.

68. Sufficient appropriate audit evidence could not be obtained that all contracts and quotations were awarded in accordance with the legislative requirements and a procurement process which is fair, equitable, transparent and competitive as the municipality did not have an adequate filing system in place.

Expenditure management

69. Money owing by the municipality was not always paid within 30 days or an agreed period, as required by section 65(2)(e) of the MFMA.

70. Reasonable steps were not taken to prevent unauthorised expenditure, irregular expenditure and fruitless and wasteful expenditure, as required by section 62(1)(d) of the MFMA.

Human resources

71. An acting municipal manager was appointed for a period of more than six months, in contravention of section 54A(2A)of the MSA.

72. Sufficient appropriate audit evidence could not be obtained that the chief financial officer, head of supply chain management, senior managers, finance officials at middle management and supply chain management managers met any of the prescribed competency areas as required by sections 83 and 119 of the MFMA and regulations 4 to 11 of the Municipal Regulations on Minimum Competency Levels.

Conditional grants

73. The allocation for the integrated national electrification programme (municipal) grant was utilised for purposes other than those stipulated in the grant framework, in contravention of section 16(1) of the DoRA.

74. Projects funded by the integrated national electrification programme grant were not implemented in line with the details contained in the integrated development plan, as required by the *Division of Revenue Grant Framework, Gazette No.35399.*

Financial misconduct

75. Unauthorised, irregular as well as fruitless and wasteful expenditure incurred by the municipality was not investigated to determine if any person is liable for the expenditure, in accordance with the requirements of section 32(2) of the MFMA.

76. Unauthorised, irregular and fruitless and wasteful expenditure was not always recovered from the liable person, as required by section 32(2) of the MFMA.

Internal control

77. I considered internal control relevant to my audit of the financial statements, annual performance report and compliance with laws and regulations. The matters reported below under the fundamentals of internal control are limited to the significant deficiencies

that resulted in the basis for qualified opinion and the findings on compliance with laws and regulationsincluded in this report.

Leadership

78. Management does not always appropriately provide the required supervision and review over the operations of the municipality to ensure that it complies with all laws and regulations and appoint the necessary skilled staff members. Action plans were developed but not fully implemented, hence the recurrence of findings identified in the prior year with regard to asset, cashand revenue management.

Financial and performance management

79. A lack of adequate technical knowledge within management and a lack of adherence to laws and regulations resulted in the adverse audit opinion on the financial statements.

80. A lack of technical knowledge in the finance section with regard to accounting standards and legislation applicable to the municipality to adequately perform their functions relating to regular reconciliations, adherence to laws and regulations and reporting against predetermined objectives.

81. There is no monitoring of, and controls within the performance management process to ensure performance against predetermined objectives are useful and reliable.

Governance

82. Management's ineffectiveness with the implementation of recommendations from internal and external audit prevented the audit committee from promoting accountability and service delivery through evaluating and monitoring responses to risks and providing oversight over the effectiveness of the internal control environment, including financial and performance reporting and compliance with laws and regulations.

Auditor-General

Polokwane

7 February 2014

AUDITOR GENERAL
SOUTH AFRICA